Louis D. Minion
Resale Discount

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Expedited Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration	)	CC Docket No. 00-218
In the Matter of Petition of Cox Virginia Telecom, Inc., etc.	)	CC Docket No. 00-249
In the Matter of Petition of AT&T Communications of Virginia Inc., etc.	)	CC Docket No. 00-251

VERIZON VIRGINIA INC.

SURREBUTTAL TESTIMONY OF MR. LOUIS D. MINION ON RESALE DISCOUNT

(Public Version)
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I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Louis D. Minion. My address is 1095 Avenue of the Americas, New York, NY 10012. I filed direct testimony in this case as part of the recurring cost panel on July 31, 2001.

Q. Please summarize Verizon VA's proposed resale discount.

A. As explained in the Panel Direct Testimony, Verizon VA calculated a resale discount by evaluating which of its activities and related costs it would actually avoid in providing the UNE services at issue in these proceedings on a wholesale basis rather than a retail basis. In doing this analysis, Verizon VA did not assume that it was an entirely wholesale company with no retail business and attempt to estimate how much it theoretically could avoid if it were designed to provide service on that basis. Rather, consistent with the Eighth Circuit's decision in *Iowa Utils. Bd. V. FCC,* [1/] which held that the wholesale discount should consist of those costs that "the ILEC will *actually avoid* incurring. . . , not costs that 'can be avoided,'"[2] the company analyzed its expenses by function code and removed all costs associated with activities Verizon VA performs only when it provides retail service. That calculation produces the 14.32% resale discount proposed by Verizon VA in these proceedings (for a CLEC that provides its own operator and directory assistance service).[3/]

1/ *Iowa Utils. Bd. v. FCC,* 219 F.3d 744, 755 (2000), *cert. granted sub nom., Verizon Communications, Inc. v. FCC,* 121 S. Ct. 871 (2001).

2 *id.* at 755 (emphasis added).

3/ The resale discount is 13.06% if Verizon VA is providing operator and directory assistance.

II. AT&T'S CRITICISMS OF VERIZON VA'S RESALE AVOIDED COST STUDY ARE WITHOUT MERIT

Q. Please summarize AT&T witness Kirchberger's criticisms of Verizon VA's proposed resale discount.

A. Mr. Kirchberger requests that the Commission reject Verizon VA's calculations based on two primary arguments. First, he suggests that the existing discount be left in place because the Commission has not yet revised its rules for calculating the wholesale discount in the wake of the Eighth Circuit's remand. Accordingly, he appears to suggest that the rules that the court reviewed and rejected should continue to be enforced by the agency.

Mr. Kirchberger suggests, in the alternative, that the Commission conclude that Verizon VA's reading of the Eighth Circuit decision is strained and that Verizon VA fails to properly exclude costs that it will avoid in providing resold services to resellers.[4/]

Q. Should the Commission adopt Mr. Kirchberger's recommendations that the existing discount remain in place "until the FCC has an opportunity to revise its rules"? [Kirchberger Rebuttal at 2.]

A. No. The existing discount that was imposed by the Virginia Commission under the Commission's resale rules is now contrary to the current state of the law. The Eighth Circuit decision could not be any clearer — the Court ruled that only those costs that are

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4/ Kirchberger Rebuttal at 2.

actually avoided when Verizon VA provides a service on a wholesale rather than a retail basis should be considered in calculating the wholesale discount.

Any discounts issued under the old rules should not remain in place simply because the Commission has not yet issued new rules.

Q. But if the FCC is about to issue new rules, wouldn't it be prudent to wait?

A. The Commission has rejected such an approach in these proceedings. The Commission, at AT&T/WorldCom's insistence, decided to proceed with all TELRIC costing issues notwithstanding that the TELRIC rules themselves are currently being reviewed by the Supreme Court. AT&T/WorldCom cannot have it both ways. Even if the FCC plans to reevaluate the wholesale discount rules in the near future, a discount must be decided in the context of these proceedings.

Further, no "new rules" could be forthcoming until after a notice-and-comment proceeding, which has not yet been instituted. It would be unfair, in the interim, to subject Verizon VA to a discount that has been struck down by the courts.

Q. **In attacking Verizon VA's proposed resale rate, Mr. Kirchberger argues that the rate should be rejected as "too low" because it does not make entry via resale profitable and thus does not promote competition. [Kirchberger Rebuttal at 2, 7-8.] Please comment on this argument.**

A. This argument seems to suggest that even if a rate is clearly calculated to exclude all avoided costs, it must be rejected if the CLECs do not believe it is economically attractive. Indeed, in his chart on page 8 of his testimony, Mr. Kirchberger actually seems to believe that the CLEC must in fact be guaranteed to make not only some profit, but the *same* profit as Verizon VA would earn.

Yet nowhere in the Act, the Commission's rules or the Eighth Circuit decision is it stated that the resale discount should be set at a rate that ensures resellers make a profit -- much less the precise profit earned by the ILEC.

Finally, there are more than 100,000 resold lines currently in service in Virginia – demonstrating that resale is a viable entry strategy.[5/]

Q. What is the basis for Mr. Kirchberger's argument that Verizon VA's resale discount is inconsistent with the Eighth Circuit's decision?

A. Mr. Kirchberger believes that Verizon VA has not identified all of the costs that will be avoided when providing wholesale service. He argues that when faced with competition, ILECs would be "mindful of cost control" and thus would take all opportunities to avoid costs.[6/] But this statement begs the question of what costs the ILEC rationally *could* avoid. Verizon VA has calculated which costs it actually would avoid by not providing services on a retail basis. Mr. Kirchberger provides no credible evidence that Verizon VA has failed to excluded avoided costs.

5/ West Direct at 2.

Q. Is Mr. Kirchberger correct that Verizon VA's retail avoided cost study assumes that Verizon VA is a monopoly provider, rather than assuming a fully competitive market? [Kirchberger Rebuttal at 5.]

A. No. Contrary to AT&T/WorldCom's claims, Verizon VA made no assumption in its retail avoided cost study that it is a monopoly provider. Verizon VA simply analyzed the costs that are avoided when it provides service to end users via resellers.

Q. What is Mr. Kirchberger's central example of a cost he believes Verizon VA would seek to avoid in a more competitive environment?

A. Mr. Kirchberger points to Verizon VA's advertising costs, arguing that these would be avoided.[7/] But as explained in the ACF section in Verizon's recurring panel surrebuttal testimony, this criticism is simply wrong: there are many reasons, which are detailed above, why retail advertising by Verizon would benefit its wholesale customers by spurring market interest in telecommunications services and products. The only types of retail marketing costs that would in fact be reduced in the more competitive market envisioned by Mr. Kirchberger are specific customer-contact costs such as taking an order for service or the payment of sales commissions, and not advertising costs. These costs are reflected as being avoided in the Verizon's studies.

Mr. Kirchberger also argues that as the market grows more competitive, Verizon VA would naturally *decrease* its retail advertising expenditures, on the theory that "a

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6/ Kirchberger Rebuttal at 4-5.

retailer faced with a 40% reduction in market share would likely decrease its retail advertising budget."[8] But this is entirely counterintuitive. As noted above, AT&T's response to new, aggressive competition from MCI and Sprint was most certainly not to *decrease* its advertising: that would have started an economic death spiral. Rather, as anyone who has received countless long distance solicitations knows, as competition has increased, the advertising battles in the long distance market have grown more fierce and thus the costs associated with advertising have *increased* with growing competition, not decreased.

Q. **Do you have any data that supports the fact that long distance advertising costs increased as competition increased?**

A. Yes. In response to an interrogatory request, AT&T provided its advertising expenses back to 1996.[9] While AT&T's long distance market share dropped from over 80% in 1984 to under 52% in the fourth quarter of 1998,[10] its advertising expenses have averaged an *increase* of nearly $0.8 million per year.

Similarly, AT&T responded to its competitive losses in Virginia — a drop from 67.1% of the residential direct dial toll minutes in Virginia in 1995, to 64% in 1996, and 57.8% in 1997 — with increased advertising.[11]

7/ *Id.* at 9-10.

8/ *Id.*

9/ AT&T/WorldCom Response to VZ-VA 13-10 (requesting information back through 1982) (Attachment A).

10/ 1999 FCC Report on Long Distance Market Shares (Attachment B).

Q. Do you agree with Mr. Kirchberger's claim that Verizon VA should have avoided expenses of providing operator services and directory assistance and directory listings (white pages) services? [Kirchberger Rebuttal at 10.]

A. No, if a reseller decides not to use Verizon's operator services and directory assistance and directory listings services, then it will not incur the Verizon charges associated with those services. The reseller is given a higher discount when it provides its own operator services. To also consider those costs as avoided would effectively give the reseller "double-avoidance" — once by not paying the rates in the first place and twice by artificially increasing the discount on the services that they are purchasing.

Second, as stated in the *Local Competition Order*, "[a] State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."[12] If a reseller opts not to use Verizon VA's operators, then the operator services and directory assistance and directory listings services are not part of the "telecommunications services being requested." As a result, the retail rates of these services and the expenses associated with these services should simply not be considered in determining the appropriate resale discount.

This is what Verizon VA has done in determining the appropriate resale discounts. It has removed from consideration the revenues and expenses of all services that are not to be resold (including when appropriate, operator services and directory

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[11] *Id.*

assistance and directory listings services) — but it has not (and correctly so) considered them avoided.

Q. Do you agree with Mr. Kirchberger's claim that Verizon VA applied the avoided cost standard inconsistently? [Kirchberger Rebuttal at 10.]

A. No. Mr. Kirchberger's criticism flows from his belief that Verizon VA's approach counts a cost as avoided if the CLEC will incur similar costs. Mr. Kirchberger is incorrect. Nor is it the standard required under the Act. The test is what costs Verizon VA will avoid when its end user takes the service from a reseller instead of Verizon.

More specifically, Mr. Kirchberger argues that because Verizon VA excluded 100% of the costs in account 6212 – Sales Expense, which includes the costs of developing customer-specific proposals, it should have likewise excluded other costs that are also provided by the reseller. Mr. Kirchberger misunderstands why Verizon VA excluded the costs in account 6212. As Mr. Kirchberger points out,[13/] Verizon VA would ***not*** avoid the costs of developing those proposals if a CLEC won away the customer, because Verizon VA would still prepare such proposals in order to compete with the CLEC. Verizon VA's exclusion of these costs is not a concession that a cost is avoided if the CLEC incurs a similar cost; rather, it reflects the fact that the specific customer-specific proposal costs cannot be discretely identified and backed out of the larger 6212 account. Verizon VA accordingly made the conservative decision to treat the entire account as avoided. Mr. Kirchberger's attempt to discredit Verizon's retail avoided cost

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[12] *Local Competition Order*, ¶ 864.

study on this basis is meritless, and, in fact, his observations suggest that some portions of sales expenses should not be treated as avoided.

Q. Mr. Kirchberger also suggests that if it were being consistent, Verizon VA should treat Product Advertising costs as avoided because the company would no longer perform those activities with respect to a customer that migrates to a CLEC. Is he correct? [Kirchberger Rebuttal at 11.]

A. No. Verizon VA does not incur product advertising costs one customer at a time. Product advertising is done on a mass market basis, and the fact that one customer leaves the company for a reseller would not affect the amount that Verizon VA would expend on product advertising. As a result, product advertising should not be considered an avoided cost.

Q. Please respond to Mr. Kirchberger's argument that Verizon VA failed to reduce its indirect costs related to Information Management (Account 6724) to correspond with the costs removed from its related General Purpose Computer expenses (Account 6124). [Kirchberger Rebuttal at 12.]

A. General Purpose Computer Expenses are primarily associated with physical computer hardware. When the work of a specific functional group (such as product management or sales) is treated as "avoided" for wholesale purposes, the computer hardware expenses associated with that group likewise is avoided; generally this consists of the personal computers associated with the personnel who are considered "avoided." Contrary to Mr.

13/ Kirchberger Rebuttal at 11.

Kirchberger's claims, these costs are ***not*** logically related to Information Management costs, which relate to the databases and software applications used within the company's data centers. These costs are not avoided simply because certain personnel are avoided.

For example, a program that is run to update Verizon VA plant in-service records pursuant to recent service orders — which would be charged to the Information Management account — is not avoided simply because an end-user takes service from a reseller rather than Verizon VA retail.

Mr. Kirchberger further explained in a recent data response the reason he believed that cost should be removed from the Information Management Account to correspond with the costs removed from the General Purpose Computer Expenses Account. According to Mr. Kirchberger, General Purpose Computer Expense includes costs related to "centralized data processing and information system services."[14/] These costs, however, amount to *less than 1%* of the costs in that account. It is difficult to see how this incidental amount of associated costs could lead to the conclusion that the entire Information Management account should be avoided in the same proportion as the General Purpose Computer Expense account.

Q. Please respond to Mr. Kirchberger's contention that because Verizon VA claims that where it avoids an activity, it treats as avoided the related infrastructure support, it should have treated as avoided 100% of the salaries of the people who

14/ AT&T/WorldCom Response to VZ-VA 13-11 (Attachment A).

perform avoided sales functions, their office equipment, their office space, and the related human resources costs. [Kirchberger Rebuttal at 12.]

A. The problem with Mr. Kirchberger's position is twofold: first, 100% of sales activities are not actually avoided. In reality, Verizon VA will not lose *all* its customers to CLECs. The actual avoided sales costs will, of course, reflect only whatever percentage of lines actually migrate to resellers. Thus, if 10-15% of the lines go to resellers, 10-15% of the selling costs will actually be avoided. As long as there are some sales activities that Verizon VA continues to perform, then the indirect, common costs associated with such activities are unlikely to be avoided in a direct, linear proportion to the amount of direct avoided costs.

For example, even if 10-15% of sales activities are avoided, the need for and expense of the sales office copier would not be avoided. The same is true with respect to other costs, such as office space, human resources, and other indirect costs. These costs are largely fixed, and thus they do not become avoided in a one-to-one fashion with the avoidance of direct costs.

Q. Do you agree with Mr. Kirchberger's claims that a separate discount should not be set for vertical services resold on a stand-alone basis? [Kirchberger Rebuttal at 13.]

A. No. Mr. Kirchberger again confuses the point. Even assuming that Verizon VA is required to provide stand-alone vertical features to resellers, a fact Verizon VA disputes, very few (if any) costs are avoided because Verizon VA must still provide the basic dial tone service. Mr. Kirchberger makes the irrelevant point that Verizon VA will still receive the basic dial tone rate from the customer. But this has nothing to do with the issue at hand: what costs are ***avoided*** by Verizon VA when it provides vertical features on a stand-alone basis to resellers. The answer is that virtually no costs are avoided because Verizon VA must still provision the dial tone service.

In addition, although Mr. Kirchberger contends that the costs associated with providing the basic service and the stand-alone service "could" be the same, it is difficult to see how this could be the case.[15/] Take, for example, the costs associated with mailing out a bill. Where Verizon VA has lost the customer altogether, and the CLEC provides the basic service, Verizon VA has no bill to mail to the end-user (although it must still bill the reseller). Where Verizon VA continues to provide the basic service, however, it must still send out a bill (to both the end user and the reseller). This bill must be sent even if Verizon VA does not provide call-waiting service to the end-user, but instead provides this service to the CLEC reseller who in turn serves the end-user.

Mr. Kirchberger also argues that whatever advertising or sales costs that Verizon VA treats as avoided in connection with basic retail services should be treated as avoided in connection with a stand-alone service, because Verizon VA's advertising or sales costs allegedly are "largely the same" whether it is advertising or selling basic retail or stand-alone services.[16/] This, too, is nonsensical. Even if Mr. Kirchberger's premise were correct, the logical conclusion would be that *no* costs are avoided when Verizon VA sells

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15/ *See* AT&T/WorldCom Response to VZ-VA 13-12 (Attachment A).
16/ *Id.*

the stand-alone service to the CLEC; the company would continue, according to Mr. Kirchberger's own logic, to incur "largely the same" advertising and sales costs.[17]

III. CONCLUSION

Q. Please summarize your conclusions regarding Verizon VA's proposed resale discount?

A. The Commission should adopt Verizon VA's proposed resale discount. It is based on a painstaking analysis of all of Verizon VA's costs and appropriately treats as avoided all retail costs that Verizon VA would not incur in connection with the provision of a service on a wholesale rather than a retail basis. Indeed, in some cases, Verizon VA treated all of the costs in a certain account as avoided to be conservative, even though Verizon VA still incurs a portion of these costs.

AT&T's criticisms are baseless and should be rejected.

[17] *Id.*

Declaration of Louis Minion

I declare under penalty of perjury that I have reviewed the foregoing panel testimony and that those sections as to which I testified are true and correct.

Executed this 20th day of September, 2001.

Louis Minion